IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-439

LEHMAN BROTHERS, *Petitioner,*

v.

JACOB SCHEIN, MARVIN H. SCHEIN, ANTONE F. GREGORIO, *et al.* *Respondents.*

No. 73-440

BENJAMIN SIMON, *Petitioner, et al.,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC., *Petitioners,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

INVESTORS DIVERSIFIED SERVICES, INC., *Petitioner,*

v.

ANTONE F. GREGORIO, *Respondent.*

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

EDWARD A. BERMAN
134 North LaSalle Street
Chicago, Ill. 60602
Attorney for Respondent Antone F. Gregorio

BENEDICT WOLF
845 Third Avenue
New York, N.Y. 10022
Attorney for Respondents Jacob Schein, Marvin H. Schein and Antone F. Gregorio

Of Counsel:
DONALD N. RUBY
VICTOR P. MUSKIN
WOLF POPPER ROSS WOLF & JONES
845 Third Avenue
New York, N.Y. 10022

October 12, 1973.

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BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents respectfully submit this brief in opposition to the petitions for writs of certiorari to the United States Court of Appeals for the Second Circuit filed by the defendants in the actions entitled *Schein et al.* v. *Chasen et al.* and *Gregorio* v. *Lum's et al.* The cases were heard together in the District Court and the Court of Appeals. The petitions of defendants Benjamin Simon (No. 73-440) and Lehman Brothers (No. 73-439) were filed September 6, 1973. The petition of defendants I[illegible]rs Diversified Services, Inc., Investors Variable Pa[illegible]und, Inc., and IDS New Dimensions Fund, Inc. (No. 73-495) was filed September 17, 1973. Petitioners ask this Court to review the judgment and decision of the United States Court of Appeals for the Second Circuit, entered May 10, 1973, which reversed the dismissal of these actions by the District Court for the Southern District of New York.

Opinions Below

The opinion of the Court of Appeals is reported at 478 F.2d 817 (2nd Cir. 1973). The opinion of the District Court is reported at 335 F. Supp. 329 (S.D.N.Y. 1971).

Questions Presented

1. Did the Court of Appeals for the Second Circuit in this action based upon diversity jurisdiction commit reversible error in deciding the merits of this case involving an unsettled issue of Florida common law and in not certifying the question to the Florida Supreme Court pursuant to Florida's optional certification procedure where the merits were fully briefed and argued to the Court of Appeals and where none of the parties urged or even suggested that the question of Florida law should not be decided by the Court of Appeals but rather should be certified to the Florida Supreme Court?

2. Did the Court of Appeals for the Second Circuit commit reversible error in not abstaining from a decision on the merits in this case where the merits were fully briefed and argued to the Court and none of the parties requested either the District Court or the Court of Appeals to abstain from deciding the merits of this case?

3. Did the Court of Appeals violate the principles of *Erie R. Co.* v. *Tompkins* in deciding the issue of Florida law in this case?

Statement of the Case

These actions are stockholder derivative actions in which federal jurisdiction is based upon diversity of citizenship. The cases present no federal questions. They were brought on behalf of Lum's Inc. (now known as Caesar's World, Inc. but hereinafter referred to as "Lum's"), a Florida corporation, and arise out of the defendants' alleged misuse of confidential corporate information.

The complaints charge that in November 1969, Melvin Chasen, Chief Executive Officer of Lum's, publicly announced that Lum's would have earnings of between $1.00 and $1.10 per share for its fiscal year ending July 31, 1970. However, on or about January 5, 1970, by virtue of his position with Lum's, Chasen learned that his earlier projection of an earnings increase for the second quarter was in error and that Lum's earnings for the year would only be about 75 cents per share. On January 8, 1970, before he disclosed this information to the shareholders of Lum's or the public generally, Chasen, in breach of his fiduciary duties to Lum's and its shareholders, called Simon, an institutional stock salesman of Lehman Brothers, and divulged to him the confidential information concerning Lum's earnings. Chasen also informed Simon that the disappointing

earnings were caused by problems in Lum's restaurant division, lower franchise sales and disappointing results at Caesar's Palace, a Las Vegas hotel casino owned by Lum's. On that same day after the close of trading on the New York Stock Exchange, Simon called Sit, the portfolio manager of IDS New Dimensions Fund, Inc. ("Dimensions"), and relayed the information given him by Chasen, informing Sit of the confidential source of the information. Sit immediately made the confidential information and its source known to Jundt, a manager and analyst for Investors Variable Payment Fund, Inc. ("Investors"). Both Dimensions and Investors are mutual funds for which Investors Diversified Services, Inc. ("IDS") is the investment advisor and distributor.

Based upon the nature and importance of the confidential material information which they had received from Chasen by way of Simon, IDS, Sit and Jundt determined that Dimensions and Investors should immediately sell the 83,000 shares of Lum's owned by them.

The following morning, a Friday, when trading opened on the New York Stock Exchange, Dimensions sold 40,000 shares of Lum's and Investors sold 43,000 shares of Lum's on the Exchange at approximately $17.50 per share. Each thus disposed of its entire holdings in that stock while in possession of the aforesaid confidential information and with the knowledge that such information had not been disclosed to the public generally.

At approximately 1:30 p.m. on the same day, the New York Stock Exchange halted trading in Lum's shares in anticipation of a company announcement. The announcement was made at 2:45 p.m. and contained substantially the same information that Chasen had leaked on January 8. Trading in Lum's was delayed until Monday morning, January 12, and the opening price was down over three

and one-half points from the prices Dimensions and Investors received on January 9.

The complaints charge that by reason of the foregoing, the defendants participated in or aided and abetted the breach of a fiduciary duty to Lum's and that said defendants are jointly and severally liable to Lum's for all profits made by any of them as a result thereof.

Since federal jurisdiction in this case is based upon diversity of citizenship, the New York federal courts were required to decide the case as the New York State courts would have. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938). Since Lum's is a Florida corporation, the federal courts, under the rule of *Klaxon* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941), were required to look to New York's choice of law rules to determine which law would apply to the situation at hand. In this case Florida law governed.

The District Court (Tyler, J.), while recognizing that there were no Florida cases which had previously dealt with the specific issues in this case, concluded that the decision in *Diamond* v. *Oreamuno,* 24 N.Y. 2d 494, 248 N.E. 2d 910, 301 N.Y.S. 2d 78 (1969), was not applicable to the issues herein and granted defendants' motion to dismiss pursuant to FRCP 12(b)(6) for failure to state a claim upon which relief can be granted. (App. 31a)

The Court of Appeals for the Second Circuit reversed, holding that the complaints alleged a valid claim under applicable state law. In reaching its decision, the Court of Appeals clearly recognized that its function was to decide the case on the basis of Florida law. (App. 6a) The Court observed, however, that since the Florida courts had never faced the precise issues which were present in this action:

> "* * * it is both proper and practical for this court to turn for guidance to the body of law of other jurisdic-

tions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond*, as so interpreted, to the facts presented here." (App. 7a)

The Court of Appeals then discussed *Diamond*, which specifically upheld the right of a corporation to recover profits realized by corporate officials who trade on the basis of confidential corporate information, and considered whether the rationale of *Diamond:*

"• • • should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment." (App. 8a)

The Court of Appeals concluded:

"As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the 'stretch' of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information." (App. 8a-9a)

In passing, the Court of Appeals observed that:

"• • • it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

> • • • To immunize such third parties from liability to the damaged corporation would encourage insider 'leaks' to outside friends and would defeat *Diamond's* purpose and effect." (App. 10a)

The Court of Appeals noted that its interpretation of *Diamond* and the application of the rationale of *Diamond* to the issues in the instant case were in accord with other authorities:

> "Indeed, the general rule has always been that 'one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary.' *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, e.g., *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964)." (App. 9a)

The Court of Appeals also noted that its conclusion that a valid claim was stated against the defendants in this case was supported by Florida case law dealing with the duty of a fiduciary to his *cestui:*

> "Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the 'technical fiduciary' but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only

to 'technical fiduciaries' but also to others who become 'fiduciaries' through the acquisition of confidential information which is 'owned' by someone else. See *Quinn* v. *Phipps, supra* at 420-421. When the defendants received their 'tip' from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages." (App. 11a)

Finally, the Court of Appeals rejected the arguments by Lehman Bros. and Simon that the complaints failed to state a valid claim against them because they had not personally profited by trading in Lum's stock and that they held no profits as constructive trustees of Lum's:

"• • •[•]Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.[•]" (App. 12a)

Judge Kaufman dissented, disagreeing with the majority of the Court of Appeals in the interpretation of *Diamond*

[•] Footnote omitted.

and in the application of the rationale of *Diamond* to the facts in this case. While Judge Kaufman expressed the view that the complaints did not state a valid claim against the defendants, he cited no Florida cases (or any other cases) in support of his dissenting opinion. In the last paragraph of his dissent Judge Kaufman added that the Court should have certified the issue to the Supreme Court of Florida. (App. 21a)

The issues in this case were fully briefed and argued by the parties to the Court of Appeals, including the applicability of the *Diamond* case as persuasive authority. None of the parties urged or even suggested in any way that the issues in this case should not be decided by the Court of Appeals, but rather should be certified to the Supreme Court of Florida pursuant to the optional procedure set forth in F.S.A. §25.031 and the accompanying rules. Use of the certification procedure was suggested for the first time in Judge Kaufman's dissent. The petitioners, having received an adverse decision from the Court of Appeals, now claim that it was error for the Court of Appeals to have decided the merits of this case notwithstanding the fact that petitioners never suggested in any way that the Court of Appeals should not do so.

ARGUMENT

I

The Court of Appeals Did Not Commit Reversible Error in Deciding the Merits of This Case and in Not Certifying the Issue of Florida Common Law to the Florida Supreme Court Since the Merits Were Fully Briefed and Argued to the Court of Appeals and None of the Parties Urged or Even Suggested That the Issue of Florida Law Should Not Be Decided by the Court of Appeals But Rather Should Be Certified to the Florida Supreme Court.

The petitioners herein contend that the Court of Appeals for the Second Circuit committed reversible error in deciding the issue of Florida common law in this case instead of certifying the question to the Florida Supreme Court as permitted by F.S.A. §25.031 and the accompanying court rules. Despite the absence of any federal question in this litigation, petitioners urge that this Court consider whether the Court of Appeals for the Second Circuit committed reversible error because it did not utilize a discretionary state certification procedure notwithstanding the fact that the petitioners had fully briefed and argued the merits of the case to the Court of Appeals and had never requested the Court of Appeals to certify the question or even suggested the possibility to the Court. In short, petitioners, once confident of success and quite willing to have the Court of Appeals determine the applicable state law, have changed their view in the face of an adverse decision on the merits. Raising the Florida certification procedure for the first time in their petitions for certiorari, they now ask this Court to reverse the decision below and give them a second chance.

In support of this new-found view that the Court of Appeals in the instant case should have certified the question to the Florida Supreme Court, petitioners rely primarily upon several cases in which the Court of Appeals for the Fifth Circuit followed that option. Based upon these cases, petitioners assert that the failure of the Court of Appeals for the Second Circuit to certify the issues in the instant case creates a "conflict" between the Courts of Appeals for the Second and Fifth Circuits which should be resolved by this Court. It is readily apparent, however, that petitioners' contention is baseless and that there is no conflict of law between the Circuits which requires resolution by this Court.

The Florida certification procedure is clearly discretionary. *Trail Builders Supply Co.* v. *Reagan,* 409 F. 2d 1059, 1061 (5th Cir. 1969). While the Fifth Circuit has often chosen to use this optional procedure, it has also on several occasions decided not to use it and to determine unsettled issues of Florida law itself. See e.g. *Weitzner* v. *United States,* 309 F. 2d 45 (5th Cir. 1962) (Court construes homestead provisions of Florida's constitution); *Hamilton* v. *Maryland Casualty Co.,* 368 F. 2d 768 (5th Cir. 1966) (Purely local dispute as to the meaning of an insurance contract; the court declined to certify the question even though it admitted that the state court might have been better able to resolve the issue; in deciding the issue, the court looked to the case law of 12 states); see also *Motor Vehicle Casualty Co.* v. *Atlantic National Insurance Co.,* 374 F. 2d 601 (5th Cir. 1967); *Greer* v. *Associated Indemnity Corp.,* 371 F. 2d 28 (5th Cir. 1967); *Pacific Indemnity Co.* v. *Broward Co.,* 465 F. 2d 99 (5th Cir. 1972); *Habecker* v. *Young,* 474 F. 2d 1229 (5th Cir. 1973). Furthermore, the Fifth Circuit cases which have utilized this procedure have typically involved a consented stipulation

framing the question to be certified (e.g. *A. R. Moyer Inc.* v. *Graham*, 443 F.2d 434 (5th Cir. 1971)) in contrast to the instant case where petitioners argued the merits of the case to the Court of Appeals for the Second Circuit and never even suggested that the question should be certified to the Florida Supreme Court.

Thus, the fact that the Fifth Circuit sometimes uses the Florida certification procedure, and that the Court of Appeals for the Second Circuit did not certify the question in this case where none of the parties requested certification and where the issues did not involve an interpretation of Florida legislation or matters peculiar to local Florida law, but rather involved a determination of Florida common law (which because of a dearth of relevant Florida authority required a review of various out-of-state persuasive authorities including the *Diamond* case, a New York decision), hardly presents a conflict of law between the Circuits which requires resolution by this Court as petitioners erroneously contend.

Dresner v. *City of Tallahassee*, 375 U.S. 136 (1963), 378 U.S. 539 (1964) and *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963), 378 U.S. 540 (1964), also cited by petitioners, provide no support for their position. *Dresner* was a Florida state court case in which this Court, in an exercise of discretion, certified doubtful questions of state law to the Florida Supreme Court since the resolution of these state law questions might obviate the need for this Court to determine the constitutional issues involved. *Aldrich* arose in the West Virginia state courts and was concerned with the effect to be given to a Florida judgment under the full faith and credit clause. These cases obviously lend no support to the suggestion that lower federal courts sitting in diversity jurisdiction cases are *obligated* to certify questions of state law to the Florida Supreme Court when no

federal questions are even potentially involved and where none of the parties requests such certification.

The case at bar does not involve, as petitioners would have it, a "refusal" by the Court of Appeals to certify the question. Never having been asked to do so by the parties, the Court could not have "refused." Indeed, in deciding the issues put before it, the Court of Appeals was properly performing its duties under diversity jurisdiction. *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943).

Petitioners' reliance upon *Clay* v. *Sun Insurance Office*, 363 U.S. 207 (1960) is also clearly misplaced. *Clay* reached this Court because the Court of Appeals for the Fifth Circuit had unnecessarily decided a federal constitutional question in a case which might have otherwise turned entirely on an issue of state law. Vacating the decision, this Court remanded the case to the Court of Appeals for a determination of the relevant state law. In strongly suggesting, but not explicitly mandating, use of the Florida certification procedure, this Court took particular note of the fact that the Court of Appeals had admitted that "it could not on the available materials make a confident guess how the Florida Supreme Court would construe the statute." 363 U.S. at 212.

The case at bar sharply contrasts with *Clay* in both particulars: first, there is no federal law question at issue and therefore no possibility of an unnecessary constitutional adjudication; and second, the Court of Appeals in the instant case did not express an inability to determine the state law question at issue and, in fact, determined it in a carefully reasoned opinion.

It should be emphasized that the issue before this Court is not, as petitioners would have it, whether this Court agrees with the general proposition that the Florida certification procedure is a useful device, or whether the Court

of Appeals might have used it, but rather whether the Court of Appeals committed reversible error by deciding the merits of this case and not using this discretionary procedure where the parties argued the merits of the case to the Court of Appeals and neither side ever suggested certification.

This Court has frequently expressed its reluctance to consider issues not raised in the courts below. See e.g. *Emspak* v. *United States,* 349 U.S. 190, 198 (1955); *Federal Trade Commission* v. *Travelers Health Association,* 362 U.S. 293, 298 n. 4 (1960).

Moreover, whatever "rights" petitioners may have had to have the issues of Florida law in this case certified to the Supreme Court of Florida instead of having them decided by the Court of Appeals for the Second Circuit surely must have been waived by petitioners when they argued the merits of this case to the Court of Appeals and never even raised the question of certification. See *Yakus* v. *United States,* 321 U.S. 414, 444 (1944).

Where a litigant objects to having an issue decided by a particular Judge or Court, he cannot wait until after an adverse decision has been rendered before raising his objection. *Laughlin* v. *United States,* 151 F. 2d 281 (D.C. Cir. 1945), cert. denied 326 U.S. 777 (1945); *In Re United Shoe Machinery Corp.,* 276 F. 2d 77 (1st Cir. 1960); *Pacheco* v. *People,* 300 F. 2d 759 (1st Cir. 1962); *Arnold* v. *McGuinness,* 289 F. Supp. 210 (N.D. Cal. 1968), aff'd. 400 F. 2d 392 (9th Cir. 1968), cert. denied 394 U.S. 918 (1969). As the Court of Appeals for the First Circuit stated in *United Shoe, supra* at 79, in an analogous situation involving a motion for disqualification of a judge:

> "One of the reasons for requiring promptness in filing is that a party, knowing of a ground for requesting

disqualification, can not be permitted to wait and decide whether he likes subsequent treatment that he receives. As was said in Sate ex rel. Shufeldt v. Armijo, 1935, 39 N.M. 502, at page 506, 50 P.2d 852, at page 855,

> "A litigant cannot experiment with the judge presiding over the case * * *.
>
> "* * * We cannot permit a litigant to test the mind of the trial judge like a boy testing the temperature of the water in the pool with his toe, and if found to his liking, decides to take a plunge."

It is respectfully submitted that the petitioners' claim that the Court of Appeals committed reversible error in not certifying the issues of Florida law to the Supreme Court of Florida in this case, coming as it does only after petitioners "tested the water" and found it not to their liking and without any prior suggestion from any party that the Court of Appeals should do anything other than decide the issues in this case, is clearly without merit and does not warrant the granting of certiorari.

II

The Court of Appeals Did Not Commit Reversible Error In Not Abstaining From a Decision On the Merits In This Case Where the Merits Were Fully Briefed and Argued to the Court and None of the Parties Requested the Court to Abstain From Deciding the Case.

Petitioner Lehman Brothers also urges that this was a proper case for invoking the doctrine of abstention, citing cases such as *Louisiana Power & Light Co.* v. *Thibodaux,* 360 U.S. 25 (1959) and *Kaiser Steel Corp.* v. *U. S. Ranch Co.,* 391 U.S. 593 (1968), notwithstanding the fact that petitioners never requested the Court of Appeals to

abstain from a decision in this case. It is doubly inappropriate for this issue to be raised here by Lehman Brothers for the first time since it could have been raised previously not only in the Court of Appeals but also in the District Court. For the reasons set forth in Point I *supra*, we respectfully submit that the petitioners, by not raising this issue in either of the courts below must be deemed to have waived whatever rights they may have had under the abstention doctrine and that they should not be permitted to raise this issue for the first time in this Court.

Moreover, the abstention doctrine, even had it been properly raised below, is inapplicable. This Court stated in *Meredith* v. *City of Winter Haven, supra:*

> "Congress having adopted the policy of opening the federal courts to suitors in all diversity cases involving the jurisdictional amount, we can discern in its action no recognition of a policy which would exclude cases from the jurisdiction merely because they involve state law or because the law is uncertain or difficult to determine." 320 U.S. at 236.

And this view was reaffirmed in *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), where this Court stated once again that in diversity jurisdiction, the "difficulties and perplexities of state law are no reason for referral of the problem to the state court." 373 U.S. at 673 n.5.

This case presents none of the classic conflicts which have led this Court to order abstention under certain limited conditions. Thus, there is no possibility here that a federal court might misconstrue a complex state regulatory scheme, as in *Alabama Public Service Commission* v. *Southern Ry. Co.*, 341 U.S. 341 (1951), unnecessarily decide a federal constitutional issue, as in *Reetz* v. *Bozanich*, 397 U.S. 82 (1970), or unnecessarily involve itself in the interpretation

of local condemnation statutes, as in *Louisiana Power & Light Co.* v. *Thibodaux, supra.** Nor is this a situation where a state court action between the same parties is pending, as in *Kaiser Steel Corp.* v. *U. S. Ranch Co., supra.* Acceptance of Lehman's argument that "an entire absence of decisions", presumably on *any* point of state law, "mandates" abstention (Lehman Pet., p. 18) would effectively oust the federal courts from jurisdiction to decide any diversity case containing an unsettled question of state law and would therefore deprive litigants of the very choice of forum which is guaranteed by the Judical Code. While the abstention cases may have carved out exceptions to the *Meredith* rule in certain well defined areas, they have not, as petitioners imply, read *Meredith* off the books.

Petitioners' claim that the Court of Appeals committed reversible error in failing to abstain from a decision in this case is clearly unfounded and does not present any issue which would warrant this Court granting certiorari.

III

The Court of Appeals Decided the Merits of This Case in Accordance With the Principles of *Erie R. Co.* v. *Tompkins.*

In their vain attempt to have the merits of this case reheard, petitioners further argue that the Court of Appeals for the Second Circuit somehow failed to carry out its duties under *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938).

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* This Court's decision in *Thibodaux, supra,* upholding a District Judge's power to abstain *sua sponte* in limited circumstances, certainly lends no support to petitioners' claim herein, raised only *after* an adverse decision, that the Court of Appeals should not have decided the issue before it.

Under *Erie,* of course, the Court of Appeals was required to ascertain and apply the appropriate state law to the facts and circumstances of the case. Examination of that Court's analysis of the issues plainly demonstrates that it scrupulously performed that duty.

Since plaintiffs did not challenge the District Court's finding that under applicable choice of law principles, Florida law governed the action, the Court of Appeals proceeded to a discussion of the facts in the context of Florida law. In applying the law of Florida, the Court of Appeals' first problem was to determine if it could look to the unanimous New York decision in *Diamond* v. *Oreamuno, supra,* as persuasive authority. The Court noted that:

> "• • • in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court." *Baxter* v. *Lancer Industries, Inc.,* 213 F. Supp. 92 (EDNY 1963), app. denied, 324 F. 2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F. Supp. 80 (D. Conn. 1964). (App. 7a)

Since the Court found no Florida decisions directly in point the Court concluded that it was:

> "• • • both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us." (App. 7a)

The Court's express objective was:

> "• • • to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond* as so interpreted to the facts presented here." (App. 7a)

After discussing *Diamond* and its applicability to the facts in the instant case, the Court again noted that it sat "as a court of equity viewing the case as a Florida court would probably view it" and stated:

> "• • • we cannot agree that the 'stretch' of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information." (App. 8a-9a)

The Court indicated that its interpretation of *Diamond* and the application of the rationale of *Diamond* to the issues in the instant case were in accord with the general rule set forth in various authorities (*Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F. Supp. 744 (1966); see, e.g., *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line, Inc.*, 118 F. 2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F. 2d 1006, 1013 (8 Cir. 1964)) (App. 9a), that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." (App. 9a)

The Court also noted that its conclusion that a valid claim was stated against the defendants in this case was also supported by Florida case law, citing *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927), which held that "the duty of a fiduciary not to misuse the property of a cestui extends

not only to the 'technical fiduciary' but also to others who are placed in a position of trust" (App. 11a) and that persons who acquire confidential information which is "owned" by someone else are, under Florida law, fiduciaries. (App. 11a)

Finally, the Court held that Lehman Brothers and Simon were accountable for the profits made by their tippees:

> "• • • Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants." *Marcus* v. *Otis,* 168 F. 2d 649 (2 Cir. 1948), *modified,* 169 F. 2d 148 (2 Cir. 1948); *Solomon* v. *United States,* 276 F. 2d 669 (6 Cir. 1960), *cert. denied,* 364 U.S. 890 (1960), *reh. denied,* 364 U.S. 939 (1969). (App. 12a)

Petitioner IDS strangely contends that the Court of Appeals did not adequately discuss Florida law since it only cited two Florida cases in its opinion. Yet IDS itself cited no other Florida cases in its brief to the Court of Appeals (other than the cases which plaintiffs had cited which IDS claimed were "inapposite"). Under these circumstances IDS is hardly in a position to claim that the Court of Appeals ignored Florida law.

Furthermore, while petitioners disagree with the Court of Appeals' interpretation of *Diamond* and with its determination of Florida common law in this case, the petitioners did not cite to the Court of Appeals any Florida cases (or, indeed, any cases at all) to the contrary, nor

have petitioners cited any cases to this Court in their petitions for certiorari which indicate that the Court of Appeals "has decided an important question of local law in a way probably in conflict with applicable local decisions." See *Ruhlin* v. *New York Life Insurance Co.*, 304 U.S. 202, 206 (1938). The record is simply barren of any support for petitioners' claim that the Court of Appeals violated *Erie*. In short this is not a case where a federal court has attempted to substitute its judgment for that of controlling state authorities as to what the state law ought to be, see *West* v. *American Telephone & Telegraph Co.*, 311 U.S. 223 (1940); on the contrary it is an example of how a scrupulous Court of Appeals under *Erie* rigorously analyzed and applied existing principles of state law to the situation at hand. Accordingly, there is clearly no basis for certiorari to be granted in this case where there is no federal question involved. *Ruhlin* v. *New York Life Insurance Co., supra; M/V Tungus* v. *Skovgaard*, 358 U.S. 588 (1959); *Pierson* v. *Ray*, 386 U.S. 547, 558 n. 12 (1967); *Commissioner of Internal Revenue* v. *Bosch's Estate*, 387 U.S. 456, 462 (1967).

CONCLUSION

The petitions of Benjamin Simon, IDS *et al.*, and Lehman Brothers for writs of certiorari to the Court of Appeals for the Second Circuit should be denied.

Respectfully submitted,

BENEDICT WOLF
845 Third Avenue
New York, N.Y. 10022
Attorney for Respondents Jacob Schein, Marvin H. Schein and Antone F. Gregorio

EDWARD A. BERMAN
134 North LaSalle Street
Chicago, Ill. 60602
Attorney for Respondent Antone F. Gregorio

Of Counsel:

DONALD N. RUBY
VICTOR P. MUSKIN
WOLF POPPER ROSS WOLF & JONES
845 Third Avenue
New York, N. Y. 10022

APPENDICES

Appendix A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972.

(Argued October 17, 1972 Decided May 10, 1973.)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs-Appellants,

—v—

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,

Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,

Plaintiff-Appellant,

—v—

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,

Defendants-Appellees.

Appendix A—Opinion of the Court of Appeals

Before:

WATERMAN, SMITH and KAUFMAN,

Circuit Judges.

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

DONALD N. RUBY, Wolf, Popper, Ross, Wolf, & Jones, New York City, *for Schein and Gregorio.*

SCHLIFKIN & BERMAN, Chicago, Ill., *for Gregorio.*

LAURA BANFIELD, DAVID HARTFIELD, JR., White & Case, New York City, *for Simon.*

JAMES J. HAGAN, Simpson, Thacher & Bartlett, New York City, *for Lehman Brothers.*

JAMES M. BERGEN, ALLAN R. FRIEDMAN, Donovan, Leisure, Newton & Irvine, New York City, *for Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc.*

Appendix A—Opinion of the Court of Appeals

WATERMAN, *Circuit Judge:*

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund, Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm Statute (CPLR §§ 313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment port-

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1 Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

folios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.*, opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complaints for failure to state a cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year

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2 In one of the original actions consolidated below, *Gildenhorn* v. *Lum's, Inc.*, 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

3 The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimensions Fund, Inc. (Dimensions). Upon receiving the information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 10:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corpora-

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4 Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

tion's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen, Sit, and Jundt have been dismissed as defendants in that they have not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno*, 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond*,

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5 Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon this appeal.

supra, as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938); *Hausman* v. *Buckley,* 299 F.2d 696 (2 Cir. 1962), *cert. denied,* 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.,* 213 F.Supp. 92 (EDNY 1963), *app. denied,* 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond,* as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants—Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stanley Fuld, writing for a unanimous court, held that the two

directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States*, 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corporate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the

"stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, *e.g.*, *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-known general rule it could have done so in its opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S.

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6 We believe Judge Tyler erred in attaching dispositive significance to the fact that in *Diamond*, supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed *Diamond* defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, *Diamond* was not a "joint venture" case, and there is no discussion in the *Diamond* opinion as to why the complaint was dismissed against the "acquiescing" directors.

1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidential insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damages for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders" might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud.[7]

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7 This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps*, supra at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943). This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d §312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to §312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * * *

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for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308; *S.E.C.* v. *Golconda Mining Company*, 327 F.Supp. 257 (SDNY 1971).

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be, however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

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8 In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liability on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularly the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of damages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g.*, *Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 (SDNY) and an administrative suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's, et al.*, 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appellees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See

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9 We find it unnecessary to decide whether the defendants could prevail if *neither* complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and *Diamond* holds specifically that an allegation of damages is not a prerequisite to a recovery. *Diamond* v. *Oreamuno*, *supra* at 499. The case cited by defendants for the proposition that damages must be alleged (*Palma* v. *Zerbey*, 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967)) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

10 See, for example, the method employed in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

Securities and Exchange Commission v. *Texas Gulf Sulphur*, 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC*, 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.*, 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 828-829 (D.Del. 1951), *aff'd*, 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make

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1 But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information

to James Jundt, portfolio manager of IDS New Dimensions Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 83,000 shares of Lum's stock on the New York Stock Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond*, the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman

of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummeted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information," 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are barren of any allegation that the appellees—or Sit or Jundt—occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on

2 As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" principles can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, §312 of the American Law Institute's Restatement of Agency 2d, exposes the inappropriateness of holding the appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person

from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co., Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf. SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972) (affirming district court order, in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law lia-

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3 It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

bility—whose exact nature and scope remain in a formative stage—is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno, supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to an officer's or director's trading in his corporation's shares[4] —nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substi-

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4 *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

tuting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by written opinion, then may answer the certified question. *See Aldrich* v. *Aldrich*, 375 U.S. 249 (1963); *Green* v. *American Tobacco Co.*, 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

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5 The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

Appendix B

Opinion of the District Court for the Southern District of New York, December 16, 1971 reported *sub nom.*, *Gildenhorn* v. *Lum's Inc.*, 335 F. Supp. 329 (S.D.N.Y. 1971)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civ. 5733 HRT

JOSEPH GILDENHORN, as Guardian for CAROL ANN GILDENHORN,

Plaintiff,

—against—

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,

Defendants.

71 Civ. 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

—against—

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT, and JAMES R. JUNDT,

Defendants.

Appendix B—Opinion of the District Court

71 Civ. 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiff,

—against—

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS VARIABLE PAYMENT FUND, INC., IDS NEW DIMENSIONS FUND, INC., EUGENE C. SIT, JAMES R. JUNDT, and LUM'S INC.,

Defendants.

TYLER, D.J.

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b)(6) F.R. Civ. P. Alternatively, all defendants move this court to stay these actions pending a final determination in *Sanders* v. *Lum's, Inc. et al.*, 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R. Civ. P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts

1 Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

as *S.E.C.* v. *Lum's et al.*, 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points in trading on the New York Stock Exchange.

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 301 N.Y.S. 2d 78 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to

him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested by New York law in general and by *Diamond* v. *Oreamuno, supra,* in particular. Assuming that *Diamond would apply,* this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR §302(a), so as to allow out of state service to be effected upon them pursuant to CPLR §313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley,* 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines,* 304 F. Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the "• • • duties and obligations of directors and officers and their relation to the corporation and its shareholders • • • [t]he primary source of law in this area ever remains that of the state which created the corporation." *Diamond* v. *Oreamuno, supra,* at 503, 504, 301 N.Y.S. 2d at 35.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson*, 12 N.Y. 2d 473, 240 N.Y.S. 2d 743 (1963). Under this approach, a New York court will apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215, 220 n.3 (S.D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez*, 24 N.Y. 2d 569, 301 N.Y.S. 2d 519 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accordingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails "• • • to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerby*, 189 So.2d 510, 511 (Fla. D.C. App., 1966), *cert. denied* 200 So.2d 814 (and cases cited therein).

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to be sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond*. In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Luma's, was certainly a fiduciary of that corporation. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or

owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perameters as they were not fiduciaries of the corporation and did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in "* * * maintaining a reputation of integrity, an image of probity for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S. 2d at 82. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be "* * * 'private attorney generals' to * * * enforce proper behavior of corporate officers." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S. 2d at 85. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite

clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other hand, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R. Civ. P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR §302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which culminated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR §302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR §302(a)(1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn*, 26 N.Y.2d 13, 308 N.Y.S. 2d 337 (1970), a New York Court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons*, 20 N.Y. 2d 903, 285 N.Y.S. 2d 871 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla*, 357 U.S. 235, 253 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR §302(a)(2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey*, 250 F. Supp. 237 (S.D.N.Y., 1965), CPLR §302(a)(2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas*, 15 N.Y. 2d 426, 261 N.Y.S. 2d 8 (1965). *Cooper* v. *North Jersey Trust Co. etc., supra*, is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR §302(a)(2).

Finally, there can be no jurisdiction under CPLR §302 (a)(3). As the statute clearly states, the tortious act must

cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b)(2) F.R. Civ. P. The motions of the remaining defendants to dismiss under Rule 12(b)(6) F.R. Civ. P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

Dated: December 15, 1971

H. R. Tyler, Jr.
U.S.D.J.

FILED
OCT 24 1973
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

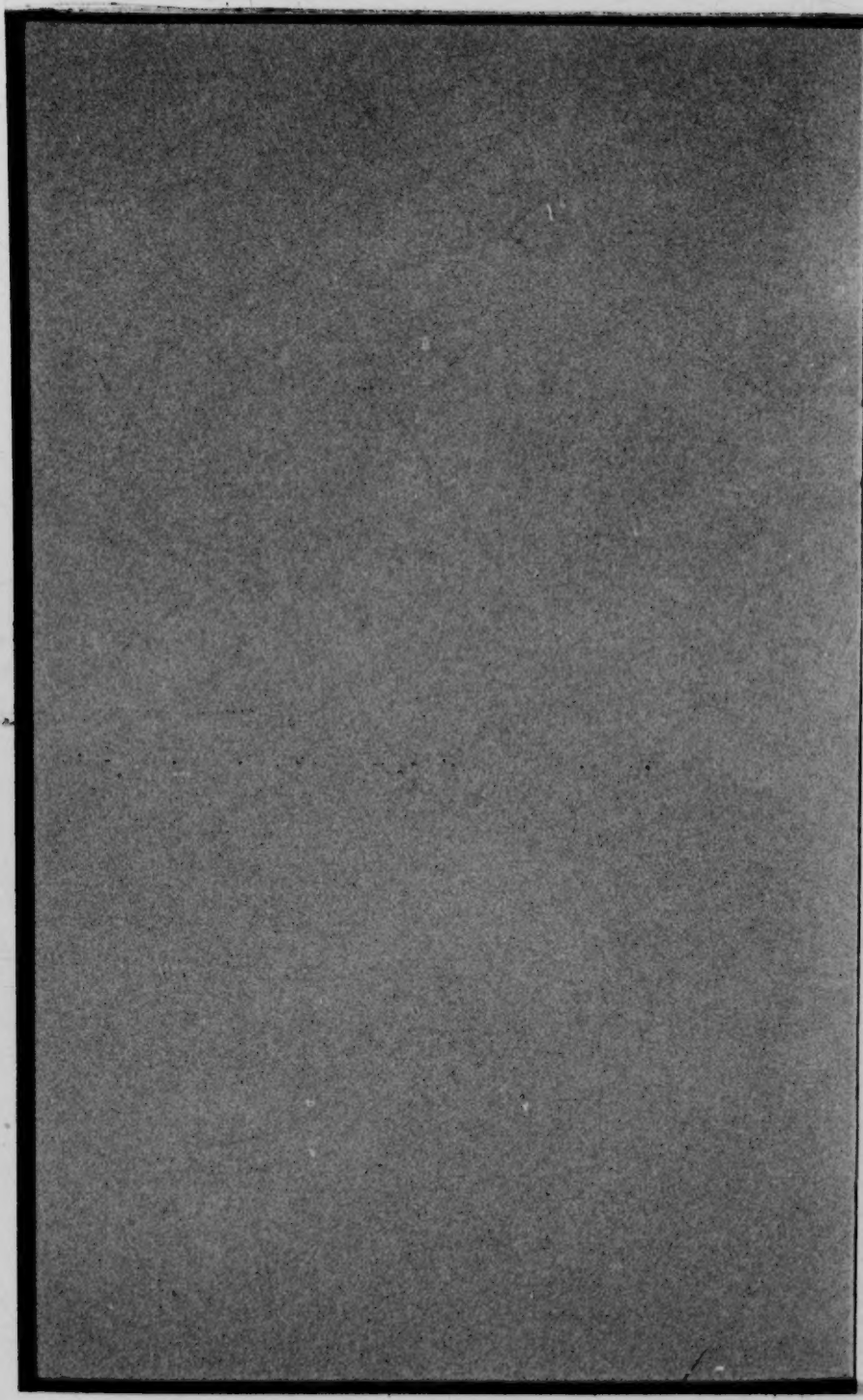
Respondents.

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

JAMES J. HAGAN
One Battery Park Plaza
New York, New York 10004
Counsel for Petitioner

Of Counsel:
LINDSAY A. LOVEJOY, JR.
SIMPSON THACHER & BARTLETT

October 24, 1973



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Respondents.

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Petitioner Lehman Brothers ("Lehman") respectfully submits this brief in reply to contentions made in the brief of respondents Schein and Gregorio in opposition to the grant of the writ of certiorari in this case.

The Refusal to Abstain and to Employ Certification

Respondents contend on several grounds that the court below was correct in announcing an extraordinary new rule as "the law of Florida" and in refusing to employ Florida's statutory certification procedure, which would have permitted the state court to decide the important issue of

Florida public policy that governs this case. All of the grounds asserted are erroneous:

1. Respondents assert that *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943), and *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), hold abstention improper here. *Meredith*, as we have pointed out (Pet. 17-18), is distinguishable and has been succeeded by *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959), where the Court refused to allow a federal court to determine an important issue of state policy by "a forecast rather than a determination," *id.*, 27, and instead ordered abstention. And in *Kaiser Steel Corp.* v. *W.S. Ranch Co.*, 391 U.S. 593 (1968), this Court, in a unanimous summary reversal, held that the federal courts should abstain to permit the state courts to settle an unresolved question of state law which was bound to recur. Moreover, respondents wholly ignore the fact that the instant case can be settled by a certification procedure which involves none of the usual cost and delay of abstention and sacrifices none of the purposes of diversity jurisdiction.

McNeese was a suit to vindicate federal rights under the Civil Rights Act, 42 U.S.C. § 1983. It held that such rights are not conditioned by any duty to exhaust state administrative remedies, since it was "immaterial whether [the state officials'] conduct is legal or illegal as a matter of state law," *id.* 674, and anyway it was "by no means clear," *id.*, that the state law gave an effective remedy. Here, in contrast, the case turns exclusively on Florida law, and it is plain that the Florida certification procedure provides an effective means to determine authoritatively what that law is.

2. Respondents assert that the duty to abstain and to certify the issue somehow turns on the consent of the parties (R. Br. 11-12). This is erroneous. There was no such

consent in *Kaiser Steel, supra,* nor in *Thibodaux,* and in both cases abstention was ordered.

3. Rather than focusing on the legal standards that establish the duty to abstain, respondents repeatedly argue that such procedure is "optional" and "discretionary" (R. Br. 9, 11, 12, 14), as if no standards existed at all. But standards do exist. This Court most recently held in *Kaiser Steel* that an issue of recurrent and primary concern to a state should be settled by the courts of that state. Otherwise a federal court's tentative decision, as in this case, to adopt a unique rule of law threatens to cause an injustice in the particular case and to interfere needlessly with the development of important state policies.

4. Respondents say there is no need for certification, since the court below "did not express an inability to determine the state law question at issue and, in fact, determined it . . ." (R. Br. 13). This argument ignores that there are no Florida precedents on point, and that the court below resolved the case only by boldly adopting and then expanding a New York rule that has been accepted in no other state. If the duty to abstain can be avoided merely by forging onward to decision at whatever cost to the law, then that duty is illusory. This Court has held otherwise, most recently in *Kaiser Steel.*

5. Respondents state several times that Lehman never asked the court below to certify the central issue herein to the Supreme Court of Florida (R. Br. 9, 10, 12, 13, 14, 15), and that the issue should thus be viewed as waived. This argument is without merit. Abstention has been ordered by this Court on its own motion even in a diversity case. *United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134 (1962).

In any case respondents are factually in error. Lehman, like the petitioner in *Kaiser Steel,* specifically sought cer-

tification in its petition for rehearing in the court below (Suggestion for Rehearing in Banc by Appellee Lehman Brothers, at 9-10 (May 24, 1973)), as we have already pointed out (Pet. 12). Moreover Judge Kaufman, in dissent, urged his brothers to use certification, failing to comprehend why they refused to do so (31A). The majority below clearly considered the certification procedure and refused to use it.

6. Respondents urge furthermore that abstention and certification are improper here since the case raises no question of federal law (R. Br. 12-13). This position is clearly rejected by *Kaiser Steel* and *Thibodaux*.

7. Respondents claim that certification is unnecessary here since "the issues did not involve . . . matters peculiar to local Florida law, but rather involved a determination of Florida common law" (R. Br. 12), which, respondents claim, the court could derive from out-of-state authorities. But Florida's common law *is* its "local law," and it is just such "local issues", see *W. S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257, 264 (CA10), *rev'd*, 391 U.S. 593 (1968), with recurrent impact that this Court and the Court of Appeals for the Fifth Circuit have referred to state courts (see Pet. 30-33). The lesson of *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), is that federal courts are not free to decide such issues for the states, either by reference to general principles or, as here, by selecting the law of another state which has sharply broken from the majority rule (see Pet. 33-36).

8. Respondents attempt to distinguish *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, *supra*, on the sole ground that in this case no state court action between the same parties

is pending (R. Br. 17).[1] The distinction is meaningless. The most practical means by far for a Florida court to resolve the main issue in this case is by certification to the Supreme Court of Florida. Unlike an ordinary civil action, such procedure could not be initiated by Lehman alone and required action by the court below. Lehman asked the court to certify the issue, and it refused; no more can be required.

The Conflicting Fifth Circuit Rule

Respondents express doubt that the central issue in this case would have been certified to the Supreme Court of Florida, had this case come to the Fifth Circuit (R. Br. 11-12). They cite several cases for the proposition that the Fifth Circuit has on occasion refused to certify an important, recurring issue involving unsettled principles of Florida law (R. Br. 11). These citations are erroneous.[2] The Fifth Circuit plainly would employ certification in a

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1. The state court action in *Kaiser Steel* was not begun until after the petitioner lost in the Court of Appeals, 388 F.2d at 266 n. 17; this Court nonetheless ordered that the federal courts should abstain so that the issues could be resolved in that state proceeding.

2. *Habecker* v. *Young*, 474 F.2d 1229 (CA5 1973) (doctrine of equitable adoption "recognized in Florida for several years," *id.*); *Pacific Indem. Co.* v. *Broward County*, 465 F.2d 99 (CA5 1972) (notice requirement in suit against county; " 'settled law'," *id.*, 102); *Motor Vehicle Cas. Co.* v. *Atlantic Nat'l Ins. Co.*, 374 F.2d 601 (CA5 1967) (construction of insurance policy; issue "neither intricate nor repetitive," *id.*, 602; principal issue had been determined before procedure for certification was established, *id.*, 603 n. 7); *Greer* v. *Associated Indem. Corp.*, 371 F.2d 29 (CA5 1967) (construction of insurance policy; "no room for doubt as to the required result," *id.*, 30); *Hamilton* v. *Maryland Cas. Co.*, 368 F.2d 768 (CA5 1966) ("[T]he question here is the simple one of whether the insurance policy says what it means and means what it says." *id.*, 769); *Weitzner* v. *United States*, 309 F.2d 45 (CA5 1962), *cert. denied*, 372 U.S. 913 (1963) ("It has long been settled that the homestead provisions of the Florida Constitution do not create property rights in the husband, wife or children," *id.*, 48).

case like this one involving an issue of significant public policy which is bound to recur (see Pet. 30-33). *Trail Builders Supply Co.* v. *Reagan,* 409 F.2d 1059 (CA5 1969), cited by respondents (R. Br. 11), so states:

> "We are convinced that [certification] would be the best way to dispose of the present case since we have no guidelines under existing Florida jurisprudence to assist us in making a determination, and since our interpretation of the exclusive remedy provision of the Florida Workmen's Compensation Act would have a significant state-wide impact." *Id.* 1061.

A plain conflict exists, and this Court is called upon to resolve it.

The Erroneous Judgment on the Merits

Respondents fail to discuss the fundamental issue of public policy raised in this case: Does a Florida corporation have an equitable right to profits that it could not rightfully make? Only New York has chosen to create such an extraordinary right, holding in the unique case of *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910 (1969), that profits wrongfully made on inside information are a legitimate "corporate opportunity." No other state has followed that rule. The decision below, adopting an extreme minority rule as "the law of Florida," is wholly without support, and we take respondents' silence as a concession of the point.

The ruling also invents a new class of fiduciaries, in an effort to extract a windfall recovery. *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927), does not support the decision below, contrary to respondents' contentions (R. Br. 19-20) and the view of the majority below (21A). *Quinn* is a perfectly conventional case about abuse of a confidential relationship by someone who was actually put in a position of trust. It does not hold that *any* person who by some means

acquires "confidential information which is 'owned' by someone else" (R. Br. 20; 21A) automatically becomes accountable as a "fiduciary" to its source, however remote.

The majority below neglected its duty under *Erie* and refused to employ the useful and enlightened Florida certification procedure, which would have equipped it with an authoritative and binding statement of the applicable standards. Instead it reached an extraordinary result wholly without the support of Florida precedents. Petitioner has thus been denied the opportunity to have its duties determined in accordance with Florida law.

CONCLUSION

For the reasons set forth above and in the Petition, the writ of certiorari should be granted and the judgment of the Court of Appeals for the Second Circuit reversed.

Respectfully submitted,

JAMES J. HAGAN
One Battery Park Plaza
New York, New York 10004
Counsel for Petitioner

Of Counsel:
LINDSAY A. LOVEJOY, JR.
SIMPSON THACHER & BARTLETT

October 24, 1973

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,
Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,
Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO
Respondent.

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

JAMES V. HAYES
30 Rockefeller Plaza
New York, New York 10020
Counsel for Petitioners

Of counsel:

MAHLON F. PERKINS, JR.
ALLAN R. FREEDMAN
DONOVAN LEISURE NEWTON & IRVINE

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Respondent.

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Petitioners, Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., respectfully submit this brief in reply to contentions made in the brief of respondents Schein and Gregorio in opposition to the grant to the writ of certiorari in this case.

The Extraordinary Nature Of The Decision Below

Respondents have strangely postponed to the final pages of their brief (R. Br. 17-21) any treatment of the question which must be the starting point for considering petitioners' application for review by this court: What was the nature of the decision below and by what judicial process was it reached? For it is the utter failure of that decisional

process to conform to the constitutionally-mandated dictates of *Erie R.R. Co.* v. *Tompkins,* 304 U.S. 64 (1938) from which the necessity derives either for a reversal on the merits or resort to the Florida certification procedure.

Respondents' discussion of the decision below fails to confront, or even mention, its most notable feature, that it announces as the common law of Florida a proposition unknown to the law of that or any other jurisdiction, namely, the right of a corporation to a windfall recovery of profits made by "tippees" who, having no relationship whatever to the corporation, trade on the basis of information remotely obtained from that corporation. Nor do respondents make the least attempt to analyze *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910, 310 N.Y.S.2d 78, (1969) or to contest petitioners' argument (Pet. Br. 9-10) that in "stretching" *Diamond* the court below abandoned its rationale.

It therefore cannot be gainsaid, we submit, that the court below undertook to create out of whole cloth a new rule of law. The question next arises, what can be found in the jurisprudence of Florida to justify such judicial legislation? Respondents have supplied no answer of their own but have contented themselves with reciting portions of the majority opinion in which the court below described the procedures it followed. Thus little needs to be added to petitioners' analysis of those procedures (Pet. Br. 7-9) except to note again that the only Florida case relied on, *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927), involved no more than a run-of-the-mill breach of the fiduciary duty owed by an agent to his principal and that nothing in "the body of law of other jurisdictions" had any bearing on the result reached. Particularly inapplicable were the cases dealing with the liability of "co-venturers" and of one "who knowingly participates in or joins in an enterprise whereby a

violation of a fiduciary obligation is effected" (R. Br. 19) when nothing in the complaint remotely suggests that there was any joint venture or common enterprise between petitioners and Chasén, the chief executive officer of Lums (See Repondents' Statement Of The Case, R. Br. 3-5).

Since the court below struck out on its own along a path never trodden before, it is captious of respondents to charge petitioners with failing to cite Florida cases *contra* to the decision below, for cases relevant to a totally new departure simply do not exist. What has occurred here is thus entirely different from the typical case in which a determination of State law is to be made for which there is no controlling precedent. Typically, these involve the construction of a statute or the decision of issues for which precedents, one way or the other, may be found in some number. Contrast, for example, the procedures followed by the court below in this case with those followed by the Court of Appeals for the Tenth Circuit in *W.S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257 (10th Cir. 1967), rev'd. 391 U.S. 593 (1968). There the court undertook a most careful scrutiny of the principal New Mexico decisions in the area dealing with the law of water rights and eminent domain and based its decision upon an analysis of those State law precedents. Id. at 258-60. Even so, the Supreme Court deemed that the Court of Appeals should have abstained from attempting to predict the law of New Mexico.

Consequently, those cases cited by respondents (R. Br. 21) as militating against a grant of certiorari here do not meet the situation presented by the extraordinary decision below. It is by no means petitioners' position merely that the court below wrongly decided a question of local law, or decided it in a way in conflict with applicable local decisions or attempted to substitute its judgment for that of controlling State authorities; our position is that the court

below has charted a new course of its own without any warrant whatsoever in the law of Florida.

It is this unique aspect of the decision below which, petitioners submit, calls either for reversal on the merits or the submission of the question to the Supreme Court of Florida.

The Right to Certification

Respondents place their principal reliance on the contention that petitioners may not now seek certification because they did not seek or suggest it upon the appeal from the decision of the District Court (R. Br. 10-17). This contention is without merit.

First, it may be said that petitioners had no reason to foresee that the Court of Appeals would depart from *Erie,* as we submit that it has. On their petition for rehearing with a suggestion for rehearing *in banc,* petititioners did suggest utilization of the Florida certified question statute to obviate any difficulties the court below might have in dealing with Florida law. Moreover, Judge Kaufmann's dissent makes it clear that Florida certification was considered by the court and that the majority did "refuse" to avail itself of it. (478 F.2d 817 at 828, Pet. Appendix at 31 A)

Secondly, the compelling need for certification, as for abstention where certification is unavailable, arises from the overriding demands of "wise judicial administration." *E.g., United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134, 135 (1962). Hence both this Court and the Circuit Courts of Appeal have not hesitated in a proper case to order abstention or certification in the absence of any suggestion by the parties. *United Gas Pipe Line Co.* v. *Ideal Cement Co., supra; Clay* v. *Sun Insurance Office,* 363 U.S.

207 (1960); *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941); *Aldrich* v. *Aldrich*, 375 U.S. 249 (1963). In *Kaiser Steel* v. *W.S. Ranch Co.*, 391 U.S. 593 (1968), a diversity case involving only the question of the correct interpretation of State law under *Erie*, the Supreme Court granted a motion for abstention pending the decision of a declaratory judgment action in the New Mexico State court, although Kaiser Steel filed its declaratory action and moved for abstention only after an adverse decision by the Court of Appeals. *W.S. Ranch Co.* v. *Kaiser Steel Corp.*, *supra* at 262, 265-66.*

Petitioners submit, therefore, that they have sufficiently raised the question of certification, under applicable precedents, to justify the grant of their petition for a writ of certiorari if such a grant is otherwise warranted on the merits.

The paramount question presented by this petition is that of the proper limitations under our Federal-State system of government upon the power of the Federal courts to declare State law. Rather than to overstep those limitations, as it did by creating a novel right of corporate recovery, it was incumbent on the court below to obtain an authoritative determination from the Florida Supreme Court of the important question of Florida law it was called upon to decide.

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* Judge John R. Brown in his concurring and dissenting opinion dissented from the refusal of the majority to abstain even though he concurred without reservations in overruling the petition for rehearing since, with the materials on hand, "the conclusion reached certainly appears to be a permissible and probably the correct one." *Id.* at 262.

CONCLUSION

For these reasons and those stated in the Petition the writ of certiorari should be granted.

Respectfully submitted,

JAMES V. HAYES
30 Rockefeller Plaza
New York, New York 10020
Counsel for Petitioners

Of counsel:

MAHLON F. PERKINS, JR.
ALLAN R. FREEDMAN
DONOVAN LEISURE NEWTON & IRVINE

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